Office - Supreme Court, U. S.
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HAROLD B. WILLEY, Clerk

No. 417

In the Supreme Court of the United States

OCTOBER TERM, 1954

LEWYT CORPORATION (NOW KNOWN AS LEWYT MANUFACTURING CORPORATION), PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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The petition in this case raises three questions. The first of these corresponds to the question which is presented in *United States* v. *Olympic Radio and Television, Inc.*, No. 10, in which this Court issued a writ of certiorari to the Court of Claims on October 14, 1954. So far as this question is concerned, the Government does not oppose the review which petitioner seeks.

The second question set forth in the petition is related to the first question and, for the reasons

indicated *infra*, pages 3-5, it seems appropriate that it be reviewed contemporaneously.

The third question, however, is unrelated to the first two. In our view, it was correctly decided by the court below, involves no question of general importance, and presents no conflict. As to this question, therefore, the Government opposes review.

We shall comment briefly upon each of the questions, treating them in the order in which they are stated in the petition.

1. The first question (which corresponds to that in No. 10) is as follows: Whether, under section 122(d)(6) of the Internal Revenue Code of 1939, a taxpayer on the accrual basis, in computing its net operating loss for a particular year, may deduct the amount of excess profits taxes paid in that year but accrued in an earlier year.[1]

Affirming the Tax Court, the court below sustained the Commissioner's contention that the alternative verbs in section 122(d)(6), "paid or accrued within the taxable year" were used to comprehend, and distinguish between, taxpayers on a cash or accrual basis (*i. e.*, "paid," if on cash basis, and "accrued," if on accrual basis), and were not designed to give an accrual-basis taxpayer the right to deduct its excess profits tax in the year paid, if

[1] The pertinent provisions of the 1939 Code, sections 23(c)(1), (s), 41, 43, 48(c), 122, and 711, are set forth in the Appendix, *infra*, pp. 8-17.

the tax accrued in another year. As previously pointed out in the Government's petition and in its supplemental memorandum in No. 10, the Court of Claims has recognized that it is in conflict with the Tax Court (see *Olympic Radio and Television, Inc.* v. *United States*, 108 F. Supp. 109, 111-112), and the court below has recognized that it is in conflict with the Court of Claims (see opinion in the instant case, Pet. 43).

2. The second question is related to the first, for it also involves an interpretation of Section 122(d)(6), though in a different context, i. e., in making the adjustments provided for in Section 122(b)(1).

The latter section states that a net operating loss for a particular taxable year (here, 1946) may be carried back for two preceding years as a deduction in computing net income. It states further that the deduction shall be applied, first, to the second preceding year (i. e., 1944) and that, if not exhausted in that year, the unused balance may be applied to reduce the income of the first preceding year (i. e., 1945). The practical problem here is how much of petitioner's 1946 net operating loss is carried back to 1945. That depends upon how much had been absorbed by 1944 net income. In determining for purposes of the adjustment contemplated by Section 122(b)(1) the quantum of petitioner's 1944 net income, one is brought back by the statute to Section 122(d)(6), for Section 122(b)(1) (*infra*, p. 11) specifically directs a

"(d)(6)" adjustment to the net income for the second preceding year.[2]

In this context, the conflicting contentions as to the meaning of Section 122(d)(6) are as follows: Petitioner claims that the amount of excess profits tax which accrued in the taxable year 1944 was the amount which it reported in its 1944 return ($625,561.59);[3] the Government contends that a lesser amount, representing the sum for which petitioner was ultimately found liable ($280,540.33), was "the tax which was 'imposed' for 1944" and "was 'the amount' of the tax which 'accrued' in 1944 for purposes of this adjustment." (Pet. 44.)

While we believe the petitioner's second question was correctly decided by the court below, the fact that it involves construction of the same and of closely related language appearing in Section 122(d)(6) suggests that review of this question would be appropriate in the event that the Court should grant review of the first question presented.

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[2] Section 122(d)(6) (*infra*, p. 14) directs that "There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 [Excess Profits] paid or accrued within the taxable year * * *."

[3] Relying on the views which it expresses in connection with the first question, petitioner also contends, in the alternative, that the amount of 1943 excess profits taxes returned for that year and paid by it in 1944 in the sum of $759,916.50 is the amount of excess profits tax which should be deducted from the 1944 income. (Pet. 4.) As the court below pointed out, either under this claim or under the claim that the deduction should be in the sum of $625,561.59, the amount of excess profits taxes would exceed the amount of the 1944 income ($584,866.81) with the result that the entire 1946 net operating loss would be carried back to 1945. (Pet. 43-44.)

We note additionally that this question, like the first question, is of recurrent importance in the administration of the tax laws.[4]

3. The third question presented by the petition is whether sums tendered the Collector in 1947 in respect of contested excess profits tax for prior years, and placed by the Collector in a suspense account, constituted a *payment* of taxes in the year 1947. The practical significance of this question in the instant case is its bearing upon the quantum of net operating loss which petitioner may claim for 1947 in computing a loss carry-back. Its disposition does not in any way depend upon the other questions presented by petitioner. Indeed, as the court below observed (Pet. 34), for purposes of this contention petitioner assumed the correctness of the Tax Court's decision on its first question.

Reviewing the pertinent events with care, the Court of Appeals found (see Pet. 32-37), as had the Tax Court before it, that no settlement concerning the disputed liabilities was reached in 1947; that, in fact, petitioner was tendering its checks with

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[4] In addition to cases before the Treasury the question has been passed upon by the Tax Court in the following cases, each presently pending in a Court of Appeals on taxpayer's appeal:

Hunter Mfg. Co. v. *Commissioner*, 21 T.C. 424, appeal pending (C.A. 3d); *W. L. Maxson Corp.* v. *Commissioner*, decided January 26, 1953 (1953 P-H T.C. Memorandum Decisions, par. 53,021), supplemental opinion June 17, 1954 (1954 P-H T.C. Memorandum Decisions, par. 54,174), appeal pending (C.A. 2d); *Byrne Doors, Inc.* v. *Commissioner*, decided April 8, 1954 (1954 P-H T.C. Memorandum Decisions, par. 54,107), appeal pending (C.A. 6th).

one hand and contesting liability with the other; and that the Collector in fact received the monies, which he placed in the suspense account, not as a satisfaction of liability, either in whole or in part, but as deposits "to abide the event of the disposition of these disputes" (Pet. 36). There is no occasion for this Court to review these concurrent findings.

The courts below were plainly correct, moreover, in holding that in the circumstances found to exist there was no legal duty on the Commissioner to accept the monies as " 'payments' *pro tanto* of the asserted or putative tax liabilities" (Pet. 35). See *Rosenman* v. *United States*, 323 U. S. 658;[5] *Roles* v. *Earle*, 195 F. 2d 346 (C. A. 9th), certiorari denied, 344 U. S. 819; *Thomas* v. *Mercantile Nat. Bank at Dallas*, 204 F. 2d 943 (C. A. 5th); *Standard Brewing Co.* v. *Commissioner*, 6 B. T. A. 980, 983. Contrary to taxpayer's suggestion (Pet. 12-15), the decision below is nowise inconsistent with *McConkey* v. *Commissioner*, 199 F. 2d 892 (C. A. 4th), certiorari denied, 345 U. S. 924, nor with the Second Circuit's decision in *Bendheim* v. *Commissioner*, 214 F. 2d 26. In both of these cases, as Judge Harlan pointed out (Pet. 46), the Commissioner stated a proposed deficiency not in excess of the deposit, thereby unequivocally indicating an acceptance of the taxpayer's offer. *Standard Portland Cement Co.* v. *Commissioner*, 80 F. 2d 585

[5] While petitioner claims support from *Rosenman* (Pet. 19-21), as the Court of Appeals' opinion fully demonstrates (Pet. 36-37), that decision supports the result reached here.

(C. A. 3d), with which petitioner also claims a conflict (Pet. 13), is plainly not in point for there the taxpayer made the payment unconditionally.[6]

CONCLUSION

The Government does not oppose the grant of certiorari but urges that, if the writ is issued, it be limited to the first two questions raised by the petition.

Respectfully submitted,

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NOVEMBER, 1954.

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[6] Petitioner also states (Pet. 2, fn.) that, in connection with one of the remittances involved, it intends to urge, if certiorari is granted, that such remittance constituted a "payment" of tax under the doctrine of collateral estoppel. This contention, which likewise depends basically upon factual determinations, was summarily overruled by the Court of Appeals (Pet. 38; see, also, R. 60, 134-136).

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) [As amended by Sec. 202(a) of the Revenue Act of 1941, c. 412, 55 Stat. 687] *Taxes Generally.*—

(1) *Allowance In General.*—Taxes paid or accrued within the taxable year, except—

(A) Federal income taxes;

(B) [As amended by Sec. 105 (c) (1) of the Revenue Act of 1942, c. 619, 56 Stat. 798] war-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, section 702 of the Revenue Act of 1934, or Subchapter E of Chapter 2, or by any such provisions as amended or supplemented;

* * * * *

(s) [As added by Sec. 211 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the

net operating loss deduction computed under section 122.

* * * * *

(26 U. S. C. 1952 ed., Sec. 23.)

PART IV—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SEC. 41—GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in

section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

(26 U. S. C. 1952 ed., Sec. 43.)

SEC. 48. DEFINITIONS.

When used in this chapter—

* * * * *

(c) *"Paid or Incurred," "Paid or Accrued."*—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * * * *

(26 U. S. C. 1952 ed., Sec. 48.)

SEC. 122. [As added by Sec. 211 (b) of the Revenue Act of 1939, *supra*]. NET OPERATING LOSS DEDUCTION.

(a) [As amended by Sec. 105 (e) (3) (A) of the Revenue Act of 1942, *supra*]. *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over

the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [As amended by Sec. 153(a) of the Revenue Act of 1942, *supra*] *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(2) *Net operating loss carry-over.*—If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating

loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss and without regard to any net operating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and computed by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year).

(c) [As amended by Secs. 105(c)(3)(B) and 153(b) of the Revenue Act of 1942, *supra*] *Amount of Net Operating Loss Deduction.*— The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d)(1), (2), (3), and (4))

exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26(e));

(d) [As amended by Sec. 105(e)(3)(C) of the Revenue Act of 1942, *supra*] *Exceptions, Additions, and Limitations.*—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114(b)(2), (3), or (4);

(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23(b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations;

(3) No net operating loss deduction shall be allowed;

(4) [As amended by Sec. 150(e) of the Revenue Act of 1942, *supra*] Gains and losses from sales or exchanges of capital assets shall be taken into account without

regard to the provisions of section 117(b). As so computed the amount deductible on account of such losses shall not exceed the amount includible on account of such gains;

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed with the exceptions and limitations specified in paragraphs (1) to (4) of this subsection.

(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or excess-profits taxes paid to any foreign country or possession of the United States;

(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members

of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

* * * * *

(26 U.S.C. 1952 ed., Sec. 122.)

SEC. 711 [as added by Sec. 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974]. EXCESS PROFITS NET INCOME.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13(a)(2), for such year except that the following adjustments shall be made:

(1) *Excess profits credit computed under income credit.*—If the excess profits credit is computed under section 713, the adjustments will be as follows:

* * * * *

(J) [as added by Sec. 210(a) of the Revenue Act of 1942, *supra*] *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122(a), and the net income for any tax-

able year under section 122(b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under paragraph (2) (B) for such taxable year; * * *

* * * * *

(2) *Excess profits credit computed under invested capital credit.*—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

* * * * *

(L) [as added by Sec. 210(b) of the Revenue Act of 1942, *supra*] *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122(a), and the net income for any taxable year under section 122(b), no deduction shall be allowed for any excess profits tax imposed by this sub-chapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall

be reduced by the amount of any reduction under sub-paragraph (B) of this paragraph for such taxable year: * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 711.)

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